

V. **THERE SHOULD BE NO PRESUMPTION IN FAVOR OF ACCOUNTING RATE FLEXIBILITY.**

As AT&T has described (pp. 53-57), the Commission should not adopt its proposed presumption in favor of allowing flexible accounting rate arrangements with WTO Member countries. The NPRM acknowledges (§ 151) that "market conditions in WTO Member countries that have made weak or no market access commitments are unlikely to be sufficiently competitive to warrant deviation from the ISP," and would allow the "easy rebuttal" of the presumption on a showing that those required conditions do not exist in the foreign market. Further, as demonstrated by AT&T's analysis, less than one-fifth of WTO Member countries would meet ECO requirements on the basis of their commitments for January 1, 1998.

(footnote continued from previous page)

circuit freeze that is the subject of complaint by FT and Sprint applies only until France and Germany introduce certain reforms, which these countries' compliance with their WTO market-opening commitments will presumably fulfill. *See Sprint Corp.* 11 FCC Rcd. at 1873. However, if these countries do not fulfill these commitments, further restrictions would be necessary. This assessment should be made following the filing of the 1998 progress report, which is required "no later than March 31." *Id.* at 1874. The Commission's Declaratory Ruling and Order in *Sprint Corp.* requires Sprint to report on "whether France and Germany afford effective competitive opportunities at that time." *Id.* at 1872. Indeed, if there are "serious questions whether the anticipated measures have been taken," the Commission "will designate for hearing the issue of whether the public interest continues to be served by Sprint's holding of Section 214 facilities authorizations on the U.S.-France and U.S.-Germany routes and, if necessary, Sprint's holding of Section 214 resale authorizations on those routes." *Id.* Nothing in the WTO agreement removes the need for such a review in connection with the investments in the third largest U.S. international carrier by the *de jure* monopoly providers in France and Germany. The Commission found the transaction to be in the public interest "only if Sprint and the parties' Joint Venture compl[ied] with certain strict conditions" addressing, among other things, "the possibility that the telecommunications liberalization to which France and Germany have committed may not occur on the anticipated schedule." *Id.* at 1850.

No commenter challenges the Commission's conclusion that deviation from the International Settlements Policy is warranted only where sufficiently competitive conditions exist in the foreign market.⁷¹ However, as Sprint properly emphasizes (p. 32), there is a continued need for "threshold requirements for flexibility which guard against [] abuse." Accordingly, as AT&T has described (p. 55), any general presumption in favor of allowing flexible arrangements with WTO Member countries would neither be justified by market conditions nor required by the WTO agreement, as a neutral presumption would be equally compatible with the GATS.⁷² Nor would the opportunity to rebut the presumption provide adequate protection against competitive harm. FaciliCom's support for this approach (p. 5) overlooks the frequent difficulty in obtaining accurate information on foreign market conditions. *See* AT&T at 55.

As Sprint concludes (p. 34), the burden should rather rest, as at present, on the proponent of the flexibility arrangement. AT&T recommends the use of a neutral presumption, with the proponent, as the party likely to have superior access to foreign market information, carrying the burden of production of evidence that the relevant country is sufficiently competitive to preclude discrimination.

The necessary market conditions in the foreign country identified by the NPRM (§§ 151-52) are essentially those required by the ECO test: open market entry and

⁷¹ Contrary to the concerns expressed by the EU (§ 15) and Japan (§ 4), to take account of foreign market conditions for this purpose would be consistent with GATS requirements, as already explained with regard to licensing decisions and dominant carrier rules.

⁷² *See* Section II, *supra*.

the existence of fair rules of competition. The implementation of WTO commitments providing international facilities-based open entry, the absence of restrictions on the foreign control of international facilities-based carriers, and the adoption of the requirements of the Reference Paper⁷³ would meet all the requirements of the ECO test, which is currently the threshold test for flexibility and would continue to perform this function for non-WTO countries. This standard, restated to examine the implementation of WTO commitments, should also provide the threshold test for flexible accounting arrangements with WTO Member countries.⁷⁴

⁷³ SBC (pp. 4-5) seeks to distinguish "the principles of the Reference Paper" from "the rules in the Telecommunications Act of 1996" and claims that "rules that are different from those adopted in the U.S." may still comply with the WTO Reference Paper. However, form should not be confused with substance. As Chairman Hundt has recently emphasized, "[t]he principles governing competition in telecommunications, like the laws of physics, are the same whether one is in South Dakota or South Korea." *International Settlement Rates*, IB 96-261, Report and Order, Aug. 7, 1997, Separate Statement by Chairman Hundt, at 2. Among those core principles is "the requirement that prices for competitors to interconnect to the incumbent local exchange companies' networks be cost-based and nondiscriminatory." *Id.* This principle is a key requirement of the WTO Reference Paper, just as it is of the Telecommunications Act of 1996. The WTO Reference Paper also requires, among other things, the existence of adequate measures to prevent anticompetitive conduct by carriers with market power and independent regulation, and thus includes all the regulatory requirements of the ECO test.

⁷⁴ Sprint, which would use (p. 34) a 65 percent market share threshold test for flexibility arrangements, acknowledges (p. 34, n.38) that its approach may be less desirable than a "detailed analysis of competition."

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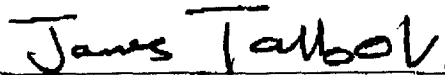
CONCLUSION

For the reasons explained above and in AT&T's Comments, the Commission should refrain from relaxing existing entry standards except as suggested herein, unless it requires the adoption of cost-based settlement rates for all types of switched services, including outbound switched resale, provided on affiliated routes. The Commission should also strengthen its proposed dominant carrier rules, adopt a neutral presumption for flexible accounting rate arrangements, and adopt the other measures described above.

Respectfully submitted,

AT&T CORP.

By



Mark C. Rosenblum
Lawrence J. Lafaro
James J. R. Talbot

Room 3252H3
295 North Maple Avenue
Basking Ridge, New Jersey 07920
(908) 221-8023

Dated. August 12, 1997

ATTACHMENT 1

List of Commenters

1. Aeronautical Radio, Inc. (ARINC)
2. Ameritech (Ameritech)
3. AT&T (AT&T)
4. BellSouth Corporation (BellSouth)
5. BT North America, Inc. (BTNA)
6. Cable & Wireless, PLC (C&W)
7. Secretary of Defense (Defense)
8. Deutsche Telekom (DT)
9. Embassy of Japan (Japan)
10. European Union, Delegation of the European Commission (EU).
11. FaciliCom International, L.L.C. (FaciliCom)
12. U.S. Department of Justice - F.B.I. (FBI)
13. France Telecom (FT)
14. Frontier (Frontier)
15. GTE Service Corporation (GTE)
16. Superintendencia de Telecomunicaciones - Guatamala, C.A. (Guatamala)
17. Indus, Inc. (Indus)
18. Kokusai Denshin Denwa Co. Ltd. (KDD)
19. MCI Telecommunications Corporation (MCI)
20. NextWave personal Communications Inc. (NextWave)
21. Nippon Telegraph and Telephone Corporation (NTT)
22. NYNEX Long Distance company (NYNEX)
23. Wei Fong, Pacific Communications Services Co., LTD. (Wei Fong)
24. PanAmSat Corporation (PanAmSat)
25. SBC Communications Inc. (SBC)
26. Shell Offshore Services Company (SOSCo)
27. Societe Internationale de Telecommunications Aeronautiques (SITA)
28. Sprint Communications Company, L.P. (Sprint)
29. Telecommunications Authority of Singapore (TAS)
30. Telecom Finland, LTD. (Telecom Finland)
31. Telefonica Internacional de Espana, S.A. (Telefonica)
32. Telefonos de Mexico, S.A. de C.V. (Telmex)
33. Telephone and Data Systems, Inc. (TDS)
34. Telstra, Inc. (TI)
35. U S West, Inc. (U S West)
36. United States Telephone Association (USTA)
37. Office of the United States Trade Representative (USTR)
38. Viatel, Inc. (Viatel)
39. Winstar communications, Inc. (Winstar)
40. Wireless Cable Association International, Inc. (WCA)
41. WorldCom, Inc. (WorldCom)

ATTACHMENT 2

TO: FCC International Bureau

From: William Lehr, on behalf of AT&T

DATE: August 4, 1997

Exhibits 1 and 2 of my affidavit illustrate that a foreign carrier with a US-based subsidiary has both the incentive and ability to execute an anticompetitive "price squeeze."¹ The example showed that a foreign carrier would find it profitable to enter the US market and to lower prices in order to stimulate additional settlement subsidies

¹ This strategy is a price squeeze in the sense that the integrated foreign carrier has an unfair cost advantage relative to all other competitors along the route between the US and the foreign carrier's home market. This cost advantage is associated with the fact that settlement rates are significantly above costs and that these settlement rates are associated with bottleneck facilities controlled by the foreign carrier. These excess settlement rates permit the integrated foreign carrier to cross-subsidize anticompetitive activities that are harmful to all other competitors along the route and may be used to finance entry to US markets, to leverage and extend its market power, and to raise rivals' costs. I place "price squeeze" in quotes because the strategy is not identical to a classical price squeeze in which an upstream monopolist prices a bottleneck facility at a higher price to non-affiliated downstream subsidiaries than it charges its own subsidiary in order to capture additional profits in the downstream market. The present case is different because (1) the downstream subsidiary also must pay the increased settlement price; (2) the settlement rate cannot be unilaterally changed by the upstream monopolist and, (3) the goal of the strategy is not limited to capturing increased profits in the downstream market. The FCC recognized the first point when it referred to the strategy as a semi-squeeze." The second point is important because settlement rates are the consequence of historical negotiations. While the foreign carrier may not be able to increase settlement rates, the foreign carrier can prevent settlement rates from decreasing. If the settlement rate is held constant, then the only way to increase the settlement subsidy is to increase the flow of net outbound minutes. The anticompetitive "price squeeze" strategy discussed here offers such an approach. Finally, the third point is important in light of on-going efforts to increase competition in foreign markets. Foreign carriers would find it advantageous to harm US IXC's (among the most likely candidates to offer increased competition) and to argue that US long domestic and international long distance services are presently earning substantial excess profits. If accepted this latter argument will deflect attention from promoting competition in foreign markets.

for the foreign parent. On a consolidated basis, the foregone profits of the US-based subsidiary are more than offset by the increased settlement subsidies. Along its affiliated route, the integrated foreign carrier is unique in its ability to profit from a strategy that inflicts losses on incumbents or other entrants to this market. Moreover, the profitability of this anticompetitive strategy is not affected by the mode of market entry.

To address this problem, I recommended in my affidavit that the FCC require that settlement rates be moved to cost (*i.e.*, the lower bound of the benchmark range proposed in the FCC's benchmark settlement order) as a precondition for foreign entry; and that this condition be applied both to switched resale entry and to facilities-based entry. Adoption of this condition is necessary in order to protect the competitive process and encourage efficient competitive entry by all potential carriers interested in serving that market.

My example was designed to present the general argument as clearly and succinctly as possible. To enhance its generality, I chose to use numerical estimates for prices, costs, and the volume of outbound minutes that are suggestive of, but not identical to those charged in any specific market. Furthermore I ignored return traffic and assumed a competitive equilibrium in the base case in order to reduce the number of parameters included in the example. I explain below why the simplifying assumptions made in my example do not affect the overall conclusion reached in my affidavit.

i. Base case assumption that the market is at a competitive equilibrium

By assuming that the US market was initially at a competitive equilibrium (*i.e.*, prices are equal to long-run economic costs), I am able to infer the equilibrium wholesale and retail prices² and assure that any price cut by the foreign subsidiary will be below cost.

The relative competitiveness of the US international market is not the issue here: permitting anticompetitive behavior is not the optimal response to

²Competitive wholesale price = wholesale costs + settlement costs = \$0.10 + \$0.25 = \$0.35; Competitive retail price = wholesale costs + retail costs + settlement costs = \$0.10 + \$0.05 + \$0.25 = \$0.40.

promote competition. Anticompetitive behavior by a dominant carrier harms all competition and cannot be the appropriate mechanism for making a market more competitive; moreover, if US international markets are already vigorously competitive, then allowing the foreign carrier the opportunity to implement a price squeeze strategy will harm the competitive process. Finally, while successful implementation of this strategy will lower prices along the affiliated route, prices will fall by less than the amount they would fall if settlement rates were moved to cost.

Therefore, the assumption that markets are initially at a competitive equilibrium is innocuous and correctly focuses attention away from an empirical issue that is irrelevant to the underlying argument. In any case, while I have not conducted a detailed empirical assessment of international competition, I believe available evidence suggests a presumption of effective competition is reasonable.³

ii. Assumption that US carriers would match a below-cost price cut by a US foreign subsidiary

The example assumes that US carriers would seek to match a price cut by the foreign subsidiary. If this were not the case, then the final market share of the foreign subsidiary would increase substantially. In my simple example, as the market share of the foreign subsidiary increases the foreign subsidiary bears a greater share of the losses imposed on the US industry. This reduces the gains from stimulating incremental settlement subsidies. However, the foreign carrier has multiple incentives to engage in anticompetitive practices. In addition to generating incremental settlement subsidies, the foreign carrier may be interested in subsidizing its entry into US

³US international markets inherit the competitiveness of US long distance markets. The presence of excess capacity, numerous facilities-based and non-facilities-based competitors and the ready availability of bulk transport capacity guarantee that entry costs are low and long-distance costs are competitive. If wholesale markets are competitive, then retail markets must be competitive also; and if the gap between retail prices and wholesale prices appears large it is because of excessive settlements and because of the high costs of acquiring customers in international markets. One would expect international marketing costs to be significantly larger than domestic marketing costs because international markets are smaller (i.e., reduced scale economies), because uncollectible problems are larger, etc.

markets more broadly -- using anticompetitive pricing along the affiliated route in order to capture a larger share of US outbound customers overall share of telecommunications service revenues.⁴ Or, the foreign carrier may be motivated by a desire to raise rivals' costs and thereby reduce the threat to monopoly profits being earned in the carrier's home market.

Furthermore, in the short-run, incremental costs are significantly below long-run incremental costs, and hence, the cost-threshold below which US carriers would find it unprofitable in the short-run to match a price cut is significantly lower than the level assumed in the example. However, any price cut below long-run economic costs would incur losses that are not sustainable in a long-run competitive equilibrium.

Finally, if demand is sufficiently elastic, the foreign subsidiary may find it rational to lower outbound prices in order to stimulate incremental settlements subsidies even if other US firms fail to match its price cut.

iii. Assumption that the foreign subsidiary captures only 10% of the market

If US competitors match the price cut by the foreign subsidiary (as argued above) then the foreign subsidiary's market share is unlikely to increase. Because the attractiveness of the strategy is inversely related to the market share necessary to induce below-cost pricing in the US international market along the route, the carrier would not be interested in acquiring a larger market share.

On the other hand, if the foreign subsidiary is interested and able to capture a significantly larger market share then its motivation may be for one of the other anticompetitive reasons suggested above. In any case, subsidizing price reductions from inefficient subsidies is not pro-competitive.

iv. Example excluded the effects of return traffic

⁴Under the FCC's current proposal, the dominant foreign carrier is the only firm able to take advantage of these excess settlement subsidies and thereby gains a regulatory-induced artificial advantage over all other competitors. This is anticompetitive.

In my original example, I ignored the effects of return traffic. In order to include the effects of return traffic, one must estimate the cross-price elasticity of return traffic when the price for US outbound traffic is reduced. Presumably, outbound and return traffic are complements. Therefore, in order to include the effects of return traffic one needs to assume a price for foreign-originated minutes and the cross-price elasticity for inbound minutes as a result of a reduction in the US outbound price.

Including return traffic significantly increases the complexity of the example, but does not affect the overall conclusion that the integrated foreign carrier has an incentive to execute an anticompetitive price squeeze strategy. To understand how this is the case, consider the following modifications to the example in Exhibit 2 of my affidavit:

- Assume that in the base case, there are 500,000 return minutes;
- that the foreign retail price is \$0.60 per minute (or, 50% higher than the US price); and,
- that the cross-price elasticity is zero so that return traffic is unaffected by a US price cut.

With these changes, the price squeeze strategy is even more attractive, resulting in a 52% increase in excess profits for the consolidated carrier of \$22,000 from \$14,500 in the original example (see Exhibit 2a).⁵ If I assume that the cross-price elasticity is sufficiently high that return traffic increases by the same proportional amount as originating traffic⁶, then the gains to the foreign carrier are even larger, or \$40,812 (see Exhibit 2b).

Note that with these changes it appears as if the US industry is initially earning excess profits of \$75,000 - or, that the US market is not at a competitive equilibrium

⁵Exhibit 2d reflects an extension of Exhibit 2. Numbers which change from the original example are highlighted in bold. For example, wholesale costs for US firms increase because of the cost of terminating the return traffic; wholesale, retail and settlement costs increase for the foreign carrier because the return traffic originated abroad.

⁶With an elasticity of 0.7, the 25% price cut results in a 17.5% increase in outbound traffic. Accordingly, return traffic also increases by 17.5%.

prior to entry. Even if this were the case, however, observe that the US industry still suffers anticompetitive losses and that these losses would not disappear unless the cross-price elasticity is unreasonably large.⁷

Furthermore, US carriers do take into account return traffic when setting prices for outbound calls. Because of return traffic, the effective settlement rate per outbound minute is less than the accounting rate. In a competitive equilibrium that properly accounted for return traffic, prices would be lower: \$0.275 per minute for wholesale and \$0.325 for retail.⁸ If these corrected prices are included in Exhibit 2a, the competitive base case is

⁷Each return minute earns a net settlement subsidy of \$0.15 (= settlement rate minus wholesale cost of termination). In order to eliminate the loss of \$38,250 sustained in Exhibit 2a, the US price cut would need to stimulate 255,000 incremental return minutes -- or, an increase of 51%, which is larger than the direct effect on outbound minutes!

⁸Each minute of outbound traffic must pay a gross settlement of \$0.25 per minute. This payment is offset by return traffic which earns a net settlement of \$0.15 per minute (= \$0.25 settlement minus \$0.10 termination costs). Because there are .5 return minutes for each outgoing minute, the effective settlement rate is \$0.175 (= \$0.25 - \$0.15*.5). Therefore, the competitive retail price is equal to \$0.325 per minute (= \$0.10 wholesale costs per outbound minute + \$0.05 retail costs per outbound minute + \$0.175 effective settlement rate per outbound minute).

restored and the addition of return traffic results in significantly larger losses for US-based firms and a larger gain for the foreign carrier relative to the original example included in my affidavit (see Exhibit 2c).

Exhibit 2: Market Impact of Foreign Entry

"Foreign carrier acquires 10% of US market and stimulates \$0.10 per minute price cut"

	Base case: before entry		Post-entry: after price cut		
	US industry	Foreign Carrier	US industry (except foreign sub)	US-based foreign subsidiary	Foreign carrier
Revenues					
Outbound traffic	\$400,000		\$317,250	\$ 35,250	
Settlements		\$250,000			\$293,750
Resale revenue					
Costs					
Wholesale costs	\$100,000	\$100,000	\$105,750	\$ 11,750	\$117,500
Retail-level costs	\$ 50,000		\$ 52,875	\$ 5,875	
Settlements	\$250,000		\$264,375	\$ 29,375	
Reseller costs					
Total Costs	\$400,000	\$100,000	\$423,000	\$ 47,000	\$117,500
Excess profit(loss)	\$0	\$150,000	(\$105,750)	(\$ 11,750)	\$176,250
 Net effect of strategy on consolidated foreign carrier					 \$ 14,500
Assumptions:					
Minutes outbound ¹	1,000,000		1,057,500	117,500	
Wholesale costs ²	\$0.10				
Retail-level costs ²	\$0.05				
Settlement rate ²	\$0.25				
Wholesale price ²	\$0.35				
Resale price ²	\$0.40		\$0.30		
Elasticity	0.7				
Share US Market	100%		90%	10%	

¹ Price cut of \$0.10 is 25% price cut. With elasticity of 0.7, this stimulates 175,000 additional minutes. For ease of computation this example ignores inbound traffic.

² Per minute.

Exhibit 3 : Market Impact of Foreign Entry via resale

"Foreign carrier acquires 10% of US market and stimulates \$0.10 per minute price cut"

	Base case: before entry		Post-entry: after price cut entry via resale		
	US industry	Foreign Carrier	US industry (except foreign sub)	US-based foreign subsidiary	Foreign carrier
Revenues					
Outbound traffic	\$400,000		\$317,250	\$ 35,250	
Settlements		\$250,000			\$293,750
Resale revenue			\$41,125		
Costs					
Wholesale costs	\$100,000	\$100,000	\$117,500		\$117,500
Retail-level costs	\$ 50,000		\$ 52,875	\$ 5,875	
Settlements	\$250,000		\$293,750		
Reseller costs				\$ 41,125	
Total Costs	\$400,000	\$100,000	\$464,125	\$ 47,000	\$117,500
Excess profit(loss)	\$0	\$150,000	(\$105,750)	(\$ 11,750)	\$176,250
Net effect of strategy on consolidated foreign carrier					\$ 14,500
Assumptions:					
Minutes outbound ¹	1,000,000		1,057,500	117,500	
Wholesale costs ²	\$0.10				
Retail-level costs ²	\$0.05				
Settlement rate ²	\$0.25				
Wholesale price ²	\$0.35				
Resale price ²	\$0.40		\$0.30		
Elasticity	0.7				
Share US Market	100%		90%	10%	

¹Price cut of \$0.10 is 25% price cut. With elasticity of 0.7, this stimulates 175,000 additional minutes.

For ease of computation this example ignores inbound traffic.

² Per minute.

Exhibit 2a: Market Impact of Foreign Entry (with return traffic)¹

"Foreign carrier acquires 10% of US market and stimulates \$0.10 per minute price cut"

	Base case: before entry		Post-entry: after price cut		
	US industry	Foreign Carrier	US industry (except foreign sub)	US-based foreign subsidiary	Foreign carrier
Revenues					
Outbound traffic	\$400,000	\$300,000	\$317,250	\$ 35,250	\$300,000
Settlements	\$125,000	\$250,000	\$112,750	\$ 12,500	\$293,750
Resale revenue					
Costs					
Wholesale costs ²	\$150,000	\$150,000	\$150,750	\$ 16,750	\$167,500
Retail-level costs	\$ 50,000	\$25,000	\$ 52,875	\$ 5,875	\$ 25,000
Settlements	\$250,000	\$125,000	\$264,375	\$ 29,375	\$125,000
Reseller costs					
Total Costs	\$450,000	\$300,000	\$468,000	\$ 52,000	\$317,500
Excess profit(loss)	\$75,000	\$250,000	(\$38,250)	(\$ 4,250)	\$276,250
 Net effect of strategy on consolidated foreign carrier					 \$ 22,000
Assumptions:					
Minutes outbound ³	1,000,000		1,057,500	117,500	
Wholesale costs ⁴	\$0.10				
Retail-level costs ²	\$0.05				
Settlement rate ²	\$0.25				
Wholesale price ²	\$0.35				
Retail price ²	\$0.40		\$0.30		
Elasticity	0.7				
Share US Market	100%		90%	10%	
Minutes Inbound	500,000		450,000	50,000	
Foreign retail price	\$0.60				

¹ Assume 500,000 minutes return traffic. Retail price cut in U.S. does not affect return traffic.

² Includes costs for originating/processing outbound minutes and to terminate inbound minutes.

³ Price cut of \$0.10 is 25% price cut. With elasticity of 0.7, this stimulates 175,000 additional minutes.

⁴ Per minute.

Exhibit 2b: Market Impact of Foreign Entry (with return traffic)¹

"Foreign carrier acquires 10% of US market and stimulates \$0.10 per minute price cut"

	Base case: before entry		Post-entry: after price cut		
	US industry	Foreign Carrier	US industry (except foreign sub)	US-based foreign subsidiary	Foreign carrier
Revenues					
Outbound traffic	\$400,000	\$300,000	\$317,250	\$ 35,250	\$352,500
Settlements	\$125,000	\$250,000	\$132,188	\$ 14,688	\$293,750
Resale revenue					
Costs					
Wholesale costs	\$150,000	\$150,000	\$158,625	\$ 17,625	\$176,250
Retail-level costs	\$ 50,000	\$25,000	\$ 52,875	\$ 5,875	\$ 29,375
Settlements	\$250,000	\$125,000	\$264,375	\$ 29,375	\$146,875
Reseller costs					
Total Costs	\$450,000	\$300,000	\$475,875	\$ 52,875	\$352,500
Excess profit(loss)	\$75,000	\$250,000	(\$26,437)	(\$ 2,937)	\$293,750
 Net effect of strategy on consolidated foreign carrier					 \$ 40,812
Assumptions:					
Minutes outbound ²	1,000,000		1,057,500	117,500	
Wholesale costs ³	\$0.10				
Retail-level costs ²	\$0.05				
Settlement rate ²	\$0.25				
Wholesale price ²	\$0.35				
Retail price ²	\$0.40		\$0.30		
Elasticity	0.7				
Share US Market	100%		90%	10%	
Minutes Inbound	500,000		528,750	58,750	
Foreign retail price	\$0.60				

¹ Assume 500,000 minutes return traffic. Retail price cut in U.S. stimulates the same percentage increase in outbound and return minutes.

² Price cut of \$0.10 is 25% price cut. With elasticity of 0.7, this stimulates 175,000 additional minutes.

³ Per minute.

Exhibit 2c: Market Impact of Foreign Entry (with return traffic)¹

"Foreign carrier acquires 10% of US market and stimulates \$0.10 per minute price cut"

	Base case: before entry		Post-entry: after price cut		
	US industry	Foreign Carrier	US industry (except foreign sub)	US-based foreign subsidiary	Foreign carrier
Revenues					
Outbound traffic	\$325,000	\$300,000	\$246,115	\$ 27,346	\$300,000
Settlements	\$125,000	\$250,000	\$112,500	\$ 12,500	\$303,846
Resale revenue					
Costs					
Wholesale costs ²	\$150,000	\$150,000	\$154,325	\$ 17,154	\$171,538
Retail-level costs	\$ 50,000	\$25,000	\$ 54,692	\$ 6,077	\$ 25,000
Settlements	\$250,000	\$125,000	\$273,462	\$ 30,385	\$125,000
Reseller costs					
Total Costs	\$450,000	\$300,000	\$482,538	\$ 53,615	\$321,538
Excess profit(loss)	\$0	\$250,000	(\$123,923)	(\$ 13,769)	\$282, ,308
 Net effect of strategy on consolidated foreign carrier					 \$ 18,538
Assumptions:					
Minutes outbound ³	1,000,000		1,093,846	121,538	
Wholesale costs ⁴	\$0.10				
Retail-level costs ³	\$0.05				
Settlement rate ³	\$0.25				
Wholesale price ³	\$0.275				
Retail price ³	\$0.325		\$0.225		
Elasticity	0.7				
Share US Market	100%		90%	10%	
Minutes Inbound	500,000		450,000	50,000	
Foreign retail price	\$0.60				

¹ Assume 500,000 minutes return traffic. Retail price cut in U.S. does not affect return traffic.


² Includes costs for originating/processing outbound minutes and to terminate inbound minutes.

³ Price cut of \$0.10 is 31% price cut (because initial price is lower). With elasticity of 0.7, this stimulates 307,692 additional minutes.

⁴ Per minute.

CERTIFICATE OF SERVICE

I, Helen Elia, do hereby certify that on this 12th day of August, 1997 a copy of the foregoing "Reply Comments of AT&T Corp." was mailed by U.S. first class mail, postage prepaid, upon the parties on the attached service list.


Helen Elia

SERVICE LIST

Ambassador Vonya B. McCann
United States Coordinator
Bureau of International
Communications and
Information Policy
Department of State
Room 4826
2201 C Street, N.W.
Washington, DC 20520-1428

Joan Donoghue
Assistant Legal Adviser for
Economic, Business and
Communications Affairs
Office of the Legal Adviser
2201 C Street, N.W.
Department of State
Washington, DC 20520-6310

Robin R. Layton
ITA
Department of Commerce
Room 4324
14th St. & Constitution NW
Washington, DC 20230

Richard Beaird
Bureau of International
Communications and
Information Policy
Department of State
Room 4836
2201 C Street, N.W.
Washington, DC 20520-1428

Steven Lett
Bureau of International
Communications and
Information Policy
Department of State
Room 4826
2201 C Street, N.W.
Washington, DC 20520-1428

Anthony Cina
Bureau of International
Communications and
Information Policy
Department of State
Room 4826
2201 C Street, N.W.
Washington, DC 20520-1428

Gary Couey
Bureau of International
Communications and Information
Policy
Department of State
Room 4826
2201 C Street, N.W.
Washington, D.C. 20520

Shirl Kinney
Deputy Assistant Secretary
for Communications and
Information
NTIA
Department of Commerce
Room 4898
14th Street & Constitution, N.W.
Washington, D.C. 20230

Suzanne Settle
 Senior Policy Advisor
 Department of Commerce NTIA
 Room 4701
 14th St. & Constitution, N.W.
 Washington, DC 20230

Jack Gleason,
 Acting Administrator
 Office of International
 Affairs
 Department of Commerce NTIA
 Room 4701
 14th St. & Constitution, N.W.
 Washington, DC 20230

Larry Irving
 Assistant Secretary for
 Communications and
 Information
 Department of Commerce NTIA
 Room 4898
 14th St. & Constitution, N.W.
 Washington, DC 20230

Barbara Wellberry
 Chief Counsel
 Department of Commerce NTIA
 Room 4713
 14 St. & Constitution Ave. NW
 Washington, DC 20230

Cathleen Wasilewski
 Attorney Advisor, Office of
 Chief Counsel
 Department of Commerce NTIA
 Room 4713
 14th St. & Constitution N.W.
 Washington, DC 20230

John Dalton
 Secretary of the Navy
 Office of the Secretary
 Department of the Navy
 The Pentagon
 Washington, DC 20310

Dr. James E. Soos
 Deputy Assistant Secretary
 of Defense for C3
 Room 3E194
 6000 Defense Pentagon
 Washington, DC 20301-6000

Carl Wayne Smith, Esq.
 Code AR Defense Information
 Systems Agency
 701 South Courthouse Road
 Arlington, VA 22204

Office of General Counsel
 National Security Agency
 9800 Savage Road
 Fort Meade, MD 20755-6000

Keith H. Fagan
 COMSAT Communications
 6560 Rockspring Drive
 Bethesda, MD 20817

John L. Bartlett
 Wiley, Rein & Fielding
 1776 K Street, NW
 Washington, DC 20006-2304
 Attorney for
 Aeronautical Radio, Inc.

Frank Michael Panek
 Ameritech
 Room 4H84
 2000 West Ameritech Center Drive
 Hoffman Estates, IL 60196-1025

William B. Barfield
 David G. Richards
 BellSouth Corporation
 1155 Peachtree Street NE
 Atlanta, GA 30309

Michael K. Kellogg
 Austin C. Schlick
 Kellogg, Huber,
 Hansen, Todd & Evans
 1301 K Street NW
 Suite 1000 West
 Washington, DC 20005
 Attorneys for BellSouth
 Corporation

Cheryl Lynn Schneider
 BT North America, Inc.
 North Building
 Suite 725
 601 Pennsylvania Avenue, NW
 Washington, DC 20004

Hogan & Hartson LLP
 Columbia Square
 555 Thirteenth Street NW
 Washington, DC 20004-1109
 Attorneys for
 BT North America, Inc.

Madeline Elizabeth Wall
 Cable & Wireless
 124 Theobalds Road
 London WC1X 8RX
 United Kingdom

Philip V. Permut
 Joan M. Griffin
 Kelley Drye & Warren LLP
 1200 19th Street NW
 Suite 500
 Washington, DC 20036
 Attys for Cable & Wireless, Inc.

Rebecca S. Weeks
 Carl Wayne Smith
 Defense Information Systems
 Agency
 701 S. Courthouse Road
 Arlington, VA 22204

Hans-Willi Hefekauser
 Deutsche Telekom AG
 Friedrich-Ebert-Allee 140
 Bonn
 Germany

A. Bradley Shingleton
 Deutsche Telekom, Inc.
 1020 19th Street NW
 Suite 850
 Washington, DC 20036

Robert J. Aamoth
 Joan M. Griffin
 Kelley Drye & Warren LLP
 1200 19th Street NW
 Suite 500
 Washington, DC 20036
 Attys for Deutsche Telekom

Junichiro Miyazaki
 Counselor of Embassy of Japan
 Embassy of Japan
 2520 Massachusetts Avenue, NW
 Washington, DC 20008

Margaret M. Charles
 Maria L. Cattafesta
 Swidler & Berlin, Chartered
 3000 K Street NW
 Suite 300
 Washington, DC 20007
 Attys for FaciliCom
 International LLC

John F. Lewis, Jr
 Assistant Director in Charge
 National Security Division
 US Department of Justice
 Federal Bureau of Investigation
 Washington, DC 20535

Theodore W. Krauss
 Danielle K. Aguto
 France Telecom North America
 555 13th Street NW
 Suite 1100 East
 Washington, DC 20004

Jeffrey P. Cunard
 Debevoise & Plimpton
 555 13th Street NW
 Suite 1100 East
 Washington, DC 20004
 Attys for France Telecom

Gerard Moine
 Alain-Louis Mie
 Jean-Louis Burillon
 France Telecom
 Public Affairs Directorate
 6, Place d'Alleray
 7505 Paris Cedex 15
 France

Michael J. Shortley, III
 Frontier Corporation
 180 South Clinton Avenue
 Rochester, New York 14646

Gail Polivy, Esq.
 GTE Service Corporation
 1850 M Street, N.W.
 Suite 1200
 Washington, DC 20036

Ward W. Wueste
 GTE Service Corporation
 One Stamford Forum
 Stamford, CT 06904

R. Michael Senkowski
 John B. Reynolds, III
 Todd D. Daubert
 Wiley, Rein & Fielding
 1776 K Street, NW
 Washington, DC 20006
 Attys for GTE Service
 Corporation

Superintendencia De.
 Telecomunicaciones
 Guatemala, C.A.

Kailas J. Rao
 Richard E. Kinder, Jr.
 Michael J. Flanigan
 INDUS, Inc.
 777 East Wisconsin Avenue
 Suite 1900
 Milwaukee, WI 53202

Philip L. Verveer
 Jennifer A. Donaldson
 Gunnar D. halley
 Willkie Farr & Gallagher
 Three Lafayette Centre
 1155 21st Street, NW
 Washington, DC 20036
 Attys for INDUS, Inc.

Robert J. Aamoth
 Joan M. Griffin
 Kelley Drye & Warren LLP
 1200 19th Street NW
 Suite 500
 Washington, DC 20036
 Attys for Kokusai Denshin
 Denwa Co. Ltd.

Sanford C. Reback
 Larry Blosser
 Carol R. Schultz
 MCI Telecommunications Corporation
 1801 Pennsylvania Ave, NW
 Washington, DC 20006

Janice Obuchowski
 Michael Wack
 Next Wave Telecom Inc.
 1101 Pennsylvania Ave. NW
 Suite 805
 Washington, DC 20005

Kevin McGilly
 Rohit Menezes
 Freedom Technologies, Inc.
 1100 New York Avenue NW
 Suite 650 East Tower
 Washington, DC 20005
 Consultants to Next Wave
 Personal Communications Inc.

Nippon Telegraph and Telephone
 Corporation
 Tokyo Opera City tower
 20-2 Nishi-Shinjuku 3-chrome
 Shinjuku-ku Tokyo
 163-14 Japan

Christopher M. Bennett
 NYNEX Long Distance Company
 1095 Avenue of the Americas
 Room 3828
 New York, NY 10036

Wei Fong
 Pacific Communications Services Co.
 20th Floor
 160 Jen ai Road Sec. 4
 Taipei, 106, Taiwan

Henry Goldberg
 Joseph A. Godles
 Mary Dent
 Panamsat Corporation
 Goldberg Godles, Weiner
 & Wright
 1229 Nineteenth Street NW
 Washington, DC 20036

James D. Ellis
 Robert M. Lynch
 Timothy P. Leahy
 SBC Communications, Inc.
 175 E. Houston
 Room 1254
 San Antonio, TX 78205

Stanley J. Moore
 SBC Communications, Inc.
 5850 W. Las Positas Blvd.
 Pleasanton, CA 94588

Wayne V. Black
 C. Douglas Jarrett
 Brian Turner Ashby
 Keller And Heckman LLP
 1001 G Street NW
 Suite 500 West
 Washington, DC 20001
 Attys for Shell Offshore Services
 Company

Albert Halprin
 Randall Cook
 Halprin, Temple, Goodman
 & Sugrue
 Suite 650 East Tower
 100 New York Avenue, NW
 Washington, DC 20005
 Attorneys for SITA

Kent Y. Nakamura
 Leon M. Kestenbaum
 Sprint Corp.
 1850 M Street, NW
 11th Floor
 Washington, DC 20036

NG Cher Keng
Telecommunication
Authority of Singapore
35 Robinson Road
TAS Building
Singapore 0106

J. Jeffrey Craven
Jeffrey L. Ross
Patton Boggs LLP
2550 M Street NW
Washington, DC 20037
Attys for Telecom Finland, LTD

Alfred M. Mamlet
Maury D. Shenk
Colleen A. Sechrest
Steptoe & Johnson LLP
1330 Connecticut Avenue NW
Washington, DC 20036
Attys for
Telefonica Internacional
de Espana, S.A.

Luis Lopez-van Dam
General Secretary
Telefonica Internacional
De Espana, S.A.
Jorge Manrique, 12
Madrid 28006
Spain

Gary M. Epstein
Teresa D. Baer
Latham & Watkins
1001 Pennsylvania Avenue NW
Washington, DC 20004
Attys for Telefonos De Mexico

George Y. Wheeler
Koteen & Naftalin LLP
1150 Connecticut Avenue NW
Suite 1000
Washington, DC 20036
Attys for Telephone and Data
Systems, Inc.

Gregory C. Staple
R. Edward Price
Koteen & Naftalin LLP
1150 Connecticut Avenue NW
Suite 1000
Washington, DC 20036
Attys for TELSTRA, Inc.

Daniel L. Poole
U S West, Inc.
1801 California Street
Suite 5100
Denver, CO 80202

Mary McDermott
Linda Kent
Keith Townsend
Hance Haney
United States Telephone
Association
1401 H Street NW
Suite 600
Washington, DC 20005

Office of the U.S. Trade Representative
Amb. Jeffrey M. Lang
600 17th Street NW
Room 201
Washington, D. C. 20508